

CALIFORNIA STATE TEACHERS' RETIREMENT BOARD

INVESTMENT COMMITTEE

SUBJECT: Fixed Income - Policies

ITEM NUMBER: 7

Currency Hedging Program

Home Loan Program

ATTACHMENT(S): 3

Long-Term Fixed Income Portfolio

ACTION: X

DATE OF MEETING: October 11, 2000

INFORMATION:

PRESENTER(S): Michelle Cunningham

EXECUTIVE SUMMARY

Each year, in preparation for the presentation of the Business Plans, the program/portfolio policies are reviewed to ensure completeness and consistency, with suggested revisions presented for the Investment Committee's approval as conditions warrant. This year, a Principal Investment Officer (PIO) position was added to the Fixed Income Unit, as a result of a promotion, thereby resulting in the need to reflect that level in the authorization limits for each of three policy manuals that would be impacted.

Attachment 1 represents the proposed changes to the Currency Hedging Program Policy Manual, which addresses the System's philosophy with respect to the potential risk to the portfolio that currency represents. **Attachment 2** represents the proposed changes to the Home Loan Program Policy Manual, which has been designed to set the boundaries for the management and oversight of that program. **Attachment 3** represents the proposed changes to the Long-Term Fixed Income Portfolio Policy Manual, which has been designed to set the boundaries that will ensure prudence and care in the management of the Long-Term Fixed Income portfolios. Each of these programs/portfolios has policies (Numbers 8, 12, and 6, respectively) regarding trading authorization limits that have been revised to reflect the inclusion of the PIO level.

RECOMMENDATION

Staff recommends, and Pension Consulting Alliance concurs, that the Investment Committee approves the policy revisions as indicated within **Attachments 1, 2 and 3**.

CalSTRS

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

CURRENCY HEDGING PROGRAM *Policies*

INVESTMENT BRANCH

~~June, 1999~~

October 2000

**California State Teachers' Retirement System
Currency Hedging Program
Policies**

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**California State Teachers' Retirement System
Currency Hedging Program
Policies**

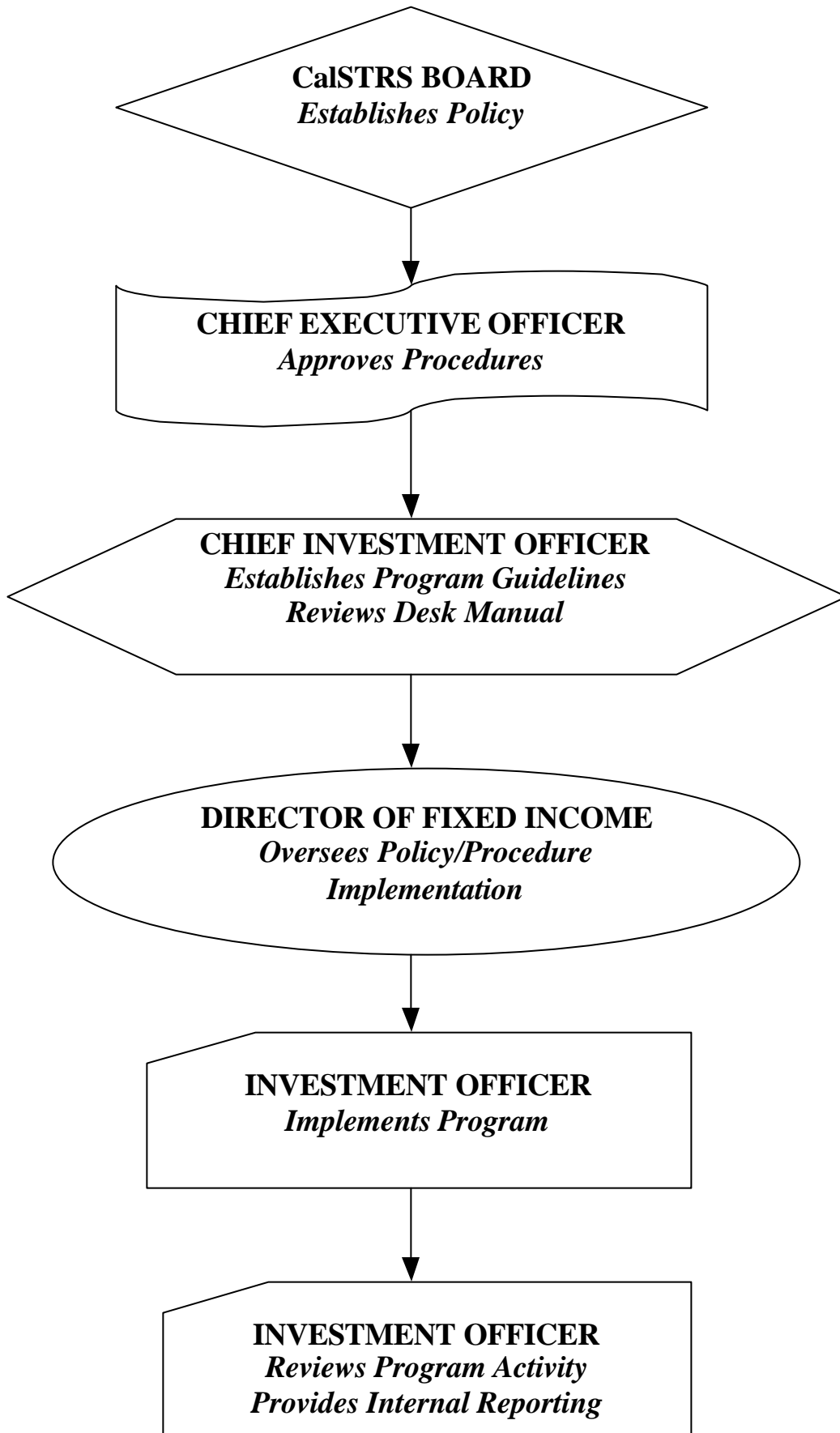
INTRODUCTION

The California State Teachers' Retirement System (CalSTRS, System) has adopted a global investment strategy, which includes a 25% strategic allocation to non-dollar investments. Whereas domestic assets are exposed to market risk, which is the probability that financial assets will rise or fall in value, non-dollar assets have two sources of risk: 1) local market risk and, 2) currency risk. For example, a portfolio of French assets may increase in value by 10% to a local (French) investor, but a U.S. investor, such as CalSTRS, would receive the 10% return plus or minus any change in the French franc to U.S. dollar currency valuation. Since currency exchange rates are not stable, the likelihood that an exchange rate will remain constant over time is very small. It is this risk relative to currency fluctuations that gives rise to currency strategies.

As described above, non-dollar investments are expected to represent a considerable portion of CalSTRS' investment portfolio. Furthermore, fifty percent (50%) of the non-dollar assets are targeted to be managed on a passive basis. Because the return associated with currency is a substantial component of the total rate of return of non-dollar investments, the currency strategy at CalSTRS could have a significant impact upon the total rate of return of the non-dollar investment portfolio. Therefore, in 1995, CalSTRS developed and implemented a Currency Hedging Program designed to reduce the risk of the passively managed segment of the non-dollar equity portfolio. As a result, controlled amounts of short currency positions are established in approved currencies when there is the risk that the U.S. dollar may strengthen.

This document outlines the approved policies of CalSTRS' Currency Hedging Program that have been designed to address the System's philosophy with respect to the potential risk to the portfolio that currency represents, and to clarify the role that currency hedging plays within the context of portfolio management. A flow chart is included to provide context for the policies within the general process of implementing the Currency Hedging Program. Words and terms that may be unfamiliar to the reader are referenced in the Glossary.

CURRENCY HEDGING PROGRAM FLOWCHART



**California State Teachers' Retirement System
Currency Hedging Program
Policies**

PROGRAM POLICIES

~~June 1999~~ *October 2000*

The following represent the approved policies to be utilized in the management of CalSTRS' Currency Hedging Program. They are designed to address the System's philosophy with respect to the potential risk to the portfolio that currency represents, and to clarify the role that currency hedging plays within the context of portfolio management. Policies approved by the CalSTRS Board cannot be altered without explicit approval from the CalSTRS Board.

1. **Laws and Statutes** – The Currency Hedging Program is to be managed in a prudent manner for the sole benefit of CalSTRS' participants and beneficiaries, in accordance with California State Teachers' Retirement Law and other applicable statutes.
2. **Program Objective** – The strategic objective for the Currency Hedging Program is to reduce the risk of the passively managed segment of the non-dollar equity portfolio by establishing controlled amounts of short currency positions in approved currencies when there is the risk that the U.S. dollar may strengthen. The performance of the Currency Hedging Program shall be evaluated in comparison to the MSCI EAFE Index on an unhedged basis.
3. **Counterparty Exposure** – A counterparty's inclusion within the Currency Hedging Program shall be evaluated, based upon the expertise and financial capacity of the firm. Due to the extended settlement practices, credit quality and size limitations will be established and documented within the Procedures Manual, and are subject to change as conditions warrant.
4. **Hedge Ratios** – Up to fifty-percent (50%) of the total market value of the passively managed segment of the non-dollar equity portfolio may be hedged. In addition, no more than one hundred-percent (100%) of each individual currency may be hedged. (No net short positions are permitted.) Any combination of approved countries can be utilized to reach the fifty-percent (50%) maximum limitation; however, no cross-hedging is permitted.
5. **Approved Countries** – Given the substantial portion of the transactions and the market capitalization of the MSCI EAFE Index that they represent, the countries for which hedging currency exposure is permitted will be limited to those represented by the Euro (Germany, France, Spain, etc.), Japan, Switzerland and the United Kingdom.
6. **Permitted Instruments** – Currency forwards, with a maximum value date of six months from the spot date, shall be utilized to establish the currency hedges. The use of currency futures, options on currencies, or options on currency futures is prohibited.

California State Teachers' Retirement System
Currency Hedging Program
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7. **Authorized Signers** – Authorization letters which indicate who may transact business for the CalSTRS Currency Hedging Program shall be sent with a copy of the most recent Currency Hedging Resolution, initially at the time an account is opened, and then periodically to all currency hedging counterparties with whom CalSTRS conducts business. Whenever a change in authorized signers takes place, the counterparties shall be notified in writing, within 24 hours in the event of termination, and as soon as possible in the event of a newly authorized signer(s).
8. **Authorization Limits** – The following daily limits apply with respect to the approval of currency hedging activity within the Currency Hedging Program:
- | | |
|--|-----------------------------|
| • Investment Officer II | \$50 million |
| • Investment Officer III | \$100 million |
| • <i>Principal Investment Officer</i> | <i>\$250 million</i> |
| • Director of Fixed Income | \$500 million |
| • Chief Investment Officer | \$1 billion |
- Prior to being processed to Operations, all currency hedging tickets shall be authorized within these limits and countersigned by two Investment Officers.
9. **Business Plan** – The Currency Hedging Program will be managed in accordance with an annual Business Plan. This plan will include a broad overview of the Currency Hedging Program, with the key issues associated with the management of the program, as well as future objectives and a resource allocation analysis.
10. **Delegation of Authority** – The management of CalSTRS' Currency Hedging Program is delegated to staff within the boundaries established by these policies and the processes described within the Procedures Manual.
11. **Reporting** – Staff will prepare a report summarizing the activities associated with the management of the Currency Hedging Program on a monthly basis for the Chief Investment Officer. The report shall provide program information, including outstanding positions, realized and unrealized gains/losses, and a counterparty review.
12. **Board Review** – The Board shall administer and review this policy periodically, as it deems appropriate, in keeping with the investment standard.
-

ADOPTED BY THE TEACHERS' RETIREMENT BOARD ON JULY 12, 1995

REVISED ON SEPTEMBER 11, 1996

REVISED ON JANUARY 7, 1998

REVISED ON JUNE 2, 1999

REVISED _____

**California State Teachers' Retirement System
Currency Hedging Program
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GLOSSARY

APPROVED CURRENCIES – The currencies of the countries where hedging exposure is permitted. The countries will be limited to those represented by the Euro, Japan, Switzerland and United Kingdom.

CROSS-HEDGING – Hedging the risk of one currency by buying or selling another currency. Because the different currencies are similar but not identical, additional risk may incur.

COUNTERPARTY – An individual or organization on the opposite side of a trade.

CURRENCY – Any form of money that is in public circulation.

CURRENCY HEDGING – A strategy used to offset the risk associated with holding non-dollar currency.

CURRENCY RISK – The risk related to currency fluctuations. For CalSTRS, it is the fluctuation of any foreign currency compared to the U.S. dollar.

EXTENDED SETTLEMENT PRACTICES – Settlement for currency forwards takes place on the value date. Value dates for CalSTRS Currency Hedging Program are limited to the one to six month area.

HEDGE RATIOS – The number of currency forwards sold against a position in the underlying currency in order to hedge the position.

MSCI EAFE INDEX – The Morgan Stanley Capital International Europe, Australia & Far East Index.

NON-DOLLAR – Investments made in currencies other than the U.S. dollar.

PRUDENT MANNER – The fiduciary is required to act in a manner appropriate in keeping with the investment standard, in the best interest and for the sole benefit of CalSTRS' participants and beneficiaries.

SHORT CURRENCY POSITION – The act of selling currency in which the seller does not have an underlying position.

VALUE DATE – Term used in relation to foreign currency to indicate the date when transferred money becomes available to the depositor.

CalSTRS

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

HOME LOAN PROGRAM *Policies*

INVESTMENT BRANCH
~~January 2000~~
October 2000

**California State Teachers' Retirement System
Home Loan Program
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**California State Teachers' Retirement System
Home Loan Program
Policies**

INTRODUCTION

The California State Teachers' Retirement System (CalSTRS) Mortgage Home Loan Program (HLP) was established in 1984 as the result of legislation that provided CalSTRS with a mortgage-backed investment opportunity, as well as an additional source of home financing for its members and retirees. Later legislation, referred to as the Dave Elder State Teachers' Retirement System Member Home Loan Program Act, enabled the California State Teachers' Retirement Board (Board) to enter into correspondent agreements with private lending institutions to facilitate the implementation of the HLP. Subsequent to the passage of that legislation, in 1986 CalSTRS began making 15 and 30 year fixed interest rate mortgage loans for the refinance or purchase of one to four family owner-occupied properties within the State of California.

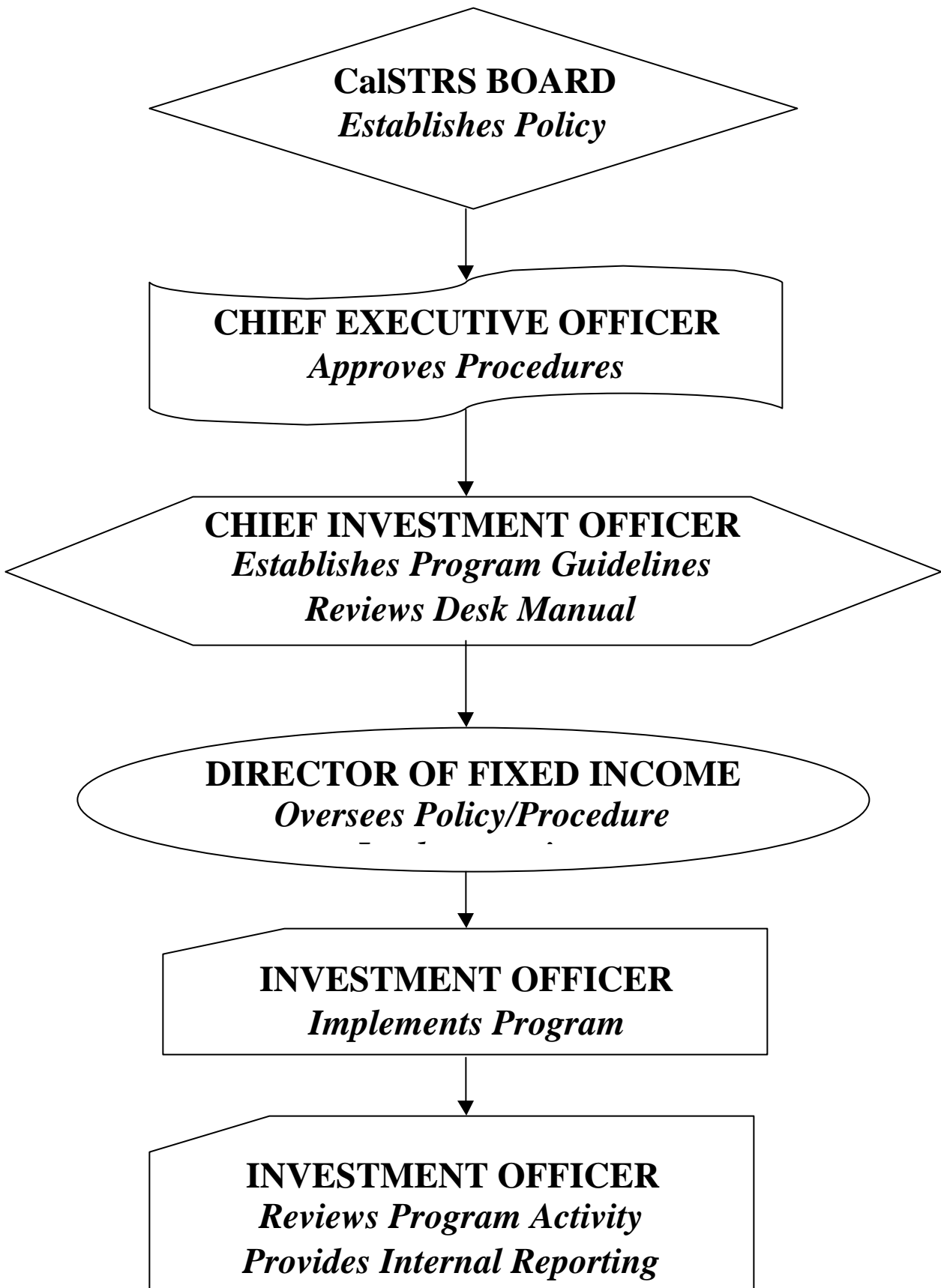
Senate Bill 1945 (SB1945), which was passed into law in August 1998, and amended in 1999, represents the most recent update to the CalSTRS HLP. Although much of the original language from the earlier Dave Elder Act has been retained, the new legislation is noteworthy in that it provides the Board the option of considering opening the HLP to borrowers who are not CalSTRS members. This legislation also permits the Board the option to provide one hundred percent (100%) financing to qualified borrowers who might otherwise have no downpayment.

Following are some of the features of the CalSTRS HLP:

- Competitive loan rates on a variety of mortgage loans.
- Highly experienced correspondent lenders working with program participants.
- Availability of purchase or refinance plans.
- Ability to participate in loan programs designed to address affordability issues.

This policy document represents the internally approved policies of CalSTRS' HLP, which have been designed to set the boundaries for the management and oversight of the program. A flow chart is included to provide the context for the policies within the general process of implementing the HLP. Words and terms that may be unfamiliar to the reader are referenced in the Glossary.

HOME LOAN PROGRAM FLOWCHART



**California State Teachers' Retirement System
Home Loan Program
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PROGRAM POLICIES

January October 2000

This document outlines the internally approved policies for the management of CalSTRS' HLP. These policies are designed to set the boundaries that will ensure prudence and care in the implementation of the program, while allowing sufficient flexibility in developing a program that is competitive and that will provide up to 100 percent (100%) home loan financing. Policies approved by the Board cannot be altered without explicit direction from the Board.

1. **Laws and Statutes** – As stated within Section 22360 of the Teacher's Retirement Law, notwithstanding any other provision of law, the Board may, pursuant to Section 22203 and in conformance with its fiduciary duty set forth in Section 22250, enter into correspondent agreements with private lending institutions within California to utilize the retirement fund to invest in residential mortgages, including assisting members, through financing, to obtain homes within the state. Furthermore, the Board shall include a procedure whereby a borrower may obtain 100 percent (100%) financing for the purchase of a single family dwelling within specified criteria.
2. **Program Objectives** – The criteria and terms for CalSTRS' home loans shall be consistent with the financial integrity of the program and the sound investment of the retirement fund. Appropriate administrative costs of implementing this program shall be paid by the participating borrowers. These costs may be included in the loan amount.
3. **Loan Rates** – Loan rates shall be periodically reviewed and adjusted as described within the Procedures and Desk Manuals to provide home loans to borrowers consistent with the financial integrity of the HLP and the sound and prudent investment of the retirement fund. Under no circumstances, however, shall the interest rates offered to borrowers be lower than the market rate.
4. **Authorized Signers** – Authorization letters that indicate who may sign on behalf of CalSTRS shall be delivered to the appropriate parties. Whenever a change in authorized signers occurs, the affected parties shall be notified within 24 hours, in the event of termination, and as soon as possible, in the event of a newly authorized signer.
5. **Business Plan** – The HLP will be managed in accordance with a Business Plan which will be prepared on an annual basis and will describe CalSTRS' goals for the HLP and will include a plan for achieving such goals over the subsequent twelve month period.
6. **Delegation of Authority** – The implementation of CalSTRS' HLP is delegated to staff within the boundaries established by these policies and the processes outlined in the Procedures Manual.

**California State Teachers' Retirement System
Home Loan Program
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7. **Reporting** – Staff will prepare monthly reports for the Chief Investment Officer which summarize the activities associated with the management of the HLP. The reports shall provide information regarding loan production, loan rates, and performance measurement.
8. **Board Review** – The Board shall administer and review this policy periodically, as it deems appropriate and in keeping with the investment standard.

MORTGAGE LOANS

9. **Property Types** – Mortgage Loans shall be made available to borrowers for the purchase or refinance of single-family dwellings, two-family dwellings, three-family dwellings, four-family dwellings, single-family cooperative apartments, and single-family condominiums.
10. **Terms and Conditions** – Mortgage Loans shall be made available under the following terms and conditions:
 - a) Borrowers shall occupy the homes as their principal residence.
 - b) Home loans shall be secured primarily by the property purchased or refinanced, and shall not exceed the appraised value of that property.
 - c) Home loans shall be available only for the purchase or refinance of homes in the State of California.
 - d) In no event shall the loan amount exceed three hundred fifty thousand dollars (\$350,000).
 - e) Prepayment penalties may be assessed on the Mortgage Loans in accordance with the rules and regulations established by the Board.
11. **Loan-to-Value Ratios (LTV)** – The terms and conditions shall provide a loan-to-value ratio of up to 100 percent (100%) of the appraised value of the property.

The portion of any loan exceeding 80 percent (80%) of value shall be insured by an admitted mortgage guaranty insurer conforming to Chapter 2A (commencing with Section 12640.01) of Part 6 of Division 2 of the Insurance Code, in an amount so that the unguaranteed portion of the loan does not exceed 75 percent (75%) of the market value of the property, together with improvements thereon.

**California State Teachers' Retirement System
Home Loan Program
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12. **Investment Limitations** – The following daily limits apply with respect to the approval of trade activity within the HLP:
- Investment Officer I – May approve up to \$5 million in loans per day.
 - Investment Officer II – May approve up to \$10 million in loans per day.
 - Investment Officer III – May approve up to \$20 million in loans per day.
 - ***Principal Investment Officer – May approve up to \$35 million in loans per day.***
 - Director of Fixed Income – May approve up to \$50 million in loans per day.
 - Chief Investment Officer – May approve up to \$100 million in loans per day.
13. **Trade Processing** – Prior to being processed to Operations, all trade tickets shall be authorized within the limits noted above, and countersigned by two investment officers within Fixed Income.

PERSONAL LOANS

14. **Eligibility** – Personal Loans permitted under this policy shall be made available only to those who are entitled to receive an allowance funded by the System, notwithstanding any vesting requirement and without regard to present eligibility to retire, and who are not retired or disabled.
15. **Terms and Conditions** – Personal Loans permitted under this policy shall be made available under the following terms and conditions:
- a) The member shall obtain one loan with a loan-to-value ratio not to exceed 95 percent (95%), secured by the purchased home, and a Personal Loan with a loan-to-value ratio not to exceed 5 percent (5%). The Personal Loan shall be secured by a portion of the accumulated retirement contributions in the member's individual account.
 - b) The 5 percent (5%) Personal Loan shall only be used for the purchase of the member's principal residence and not for a loan to refinance the member's existing mortgage.
 - c) In no event shall the loan amount, including the Personal Loan secured by the accumulated retirement contributions in the member's individual account, exceed three hundred fifty thousand dollars (\$350,000).
 - d) In no event may the Personal Loan secured by the accumulated retirement contributions in the member's individual account exceed the lesser of: 50 percent (50%) of the current value amount of the accumulated contributions or fifty thousand dollars (\$50,000).
 - e) If two members are married, the Personal Loan secured by the sum total of accumulated retirement contributions in both members' accounts shall not exceed five percent (5%) of the loan.

**California State Teachers' Retirement System
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- 16. Pledge of Security** – The pledge of security for the Personal Loan permitted under this policy shall remain in effect until the loan is paid in full, within the following constraints:
- a) If the member is married at the time the home is purchased with a Personal Loan secured by the member's accumulated retirement contributions, then the member's spouse shall agree in writing to the pledge of security, as to his or her community interest in the amount pledged, regardless of whether title to the home is in joint tenancy.
 - b) The pledge of security under this policy shall take binding effect. In the event of default on the Personal Loan, the System may recover the pledge amount pursuant to Policy #17 and implementing procedures.
- 17. Default Provisions** – In the event of a default on the Personal Loan, the Board may take action to recover the pledge amount.
- a) In the event of a default on the Personal Loan secured by the member's retirement contributions, the Board shall deduct an amount from the member's accumulated retirement contributions on deposit and adjust the member's accumulated retirement contributions as necessary to recover any outstanding loan balance prior to making any disbursement of a refund or a lump-sum distribution.
 - b) In the event of a default on the Personal Loan by a member, the Board shall deduct the monthly principal plus appropriate interest from the member's benefit, when the member begins receiving a benefit, until the loan is paid in full.
 - c) In the event of a default on the Personal Loan by a member receiving a benefit, the Board shall deduct the monthly principal and interest from the member's benefit until the Personal Loan is paid in full.
 - d) In the event of a refund or lump-sum distribution of the accumulated retirement contributions, the member's account shall be adjusted as necessary to recover any outstanding loan balance.

ADOPTED BY THE TEACHERS' RETIREMENT BOARD IN NOVEMBER 1986

REVISED ON AUGUST 20, 1990

REVISED ON NOVEMBER 4, 1998

REVISED ON APRIL 7, 1999

REVISED ON JANUARY 5, 2000

REVISED _____

**California State Teachers' Retirement System
Home Loan Program
Policies**

GLOSSARY

ACCUMULATED EMPLOYEE CONTRIBUTIONS – The employee's contribution account that includes the member's retirement contributions and any accrued interest. This account does not include the employer's contribution.

BOARD – The California State Teachers' Retirement System Board of trustees.

CORRESPONDENT AGREEMENT – The contract between CalSTRS and a private financial institution that originates and services loans, which describes the respective duties of each party.

CORRESPONDENT LENDER – The private financial institution that originates and services home loans for CalSTRS' borrowers.

DEFAULT – A member is in default when the payment due on the Personal Loan has not been remitted for 120 days.

ELIGIBILITY – The secured Personal Loan permitted under this portion of the HLP will be made available to those who are entitled to receive an allowance funded by the System, notwithstanding any vesting requirement and without regard to present eligibility to retire, and who are not retired or disabled.

LOAN RATE – The cost of using money, expressed as a rate per period of time.

LOAN-TO-VALUE RATIO – The ratio of the loan amount to the appraised value of the property. Example: A property with a loan of \$80,000 and an appraised value of \$100,000 results in a loan-to-value of 80%.

PERSONAL LOANS – The 5 percent (5%) financing that CalSTRS will loan to its members in order to finance the down payment on the purchase of a single family dwelling in California.

PLEDGE AMOUNT – The total amount of the Personal Loan. This is the loan amount, plus all accrued interest, calculated at the time of loan origination.

PREPAYMENT PENALTY – A monetary penalty assessed against the borrower, designed to inhibit the borrower's ability to refinance.

CalSTRS

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

LONG-TERM FIXED INCOME PORTFOLIO *Policies*

INVESTMENT BRANCH
~~April, 1999~~
October, 2000

**California State Teachers' Retirement System
Long-Term Fixed Income Portfolio
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Long-Term Fixed Income Portfolio
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INTRODUCTION

Fixed income portfolios can be considered unique in that they represent an investment asset class that bridges the return and risk characteristics between cash equivalents and stocks. The California State Teachers' Retirement System's (CalSTRS; System) core long-term fixed income holdings play several important roles within the investment portfolio. These roles include providing diversification, a real rate of return, and cash flow/liquidity.

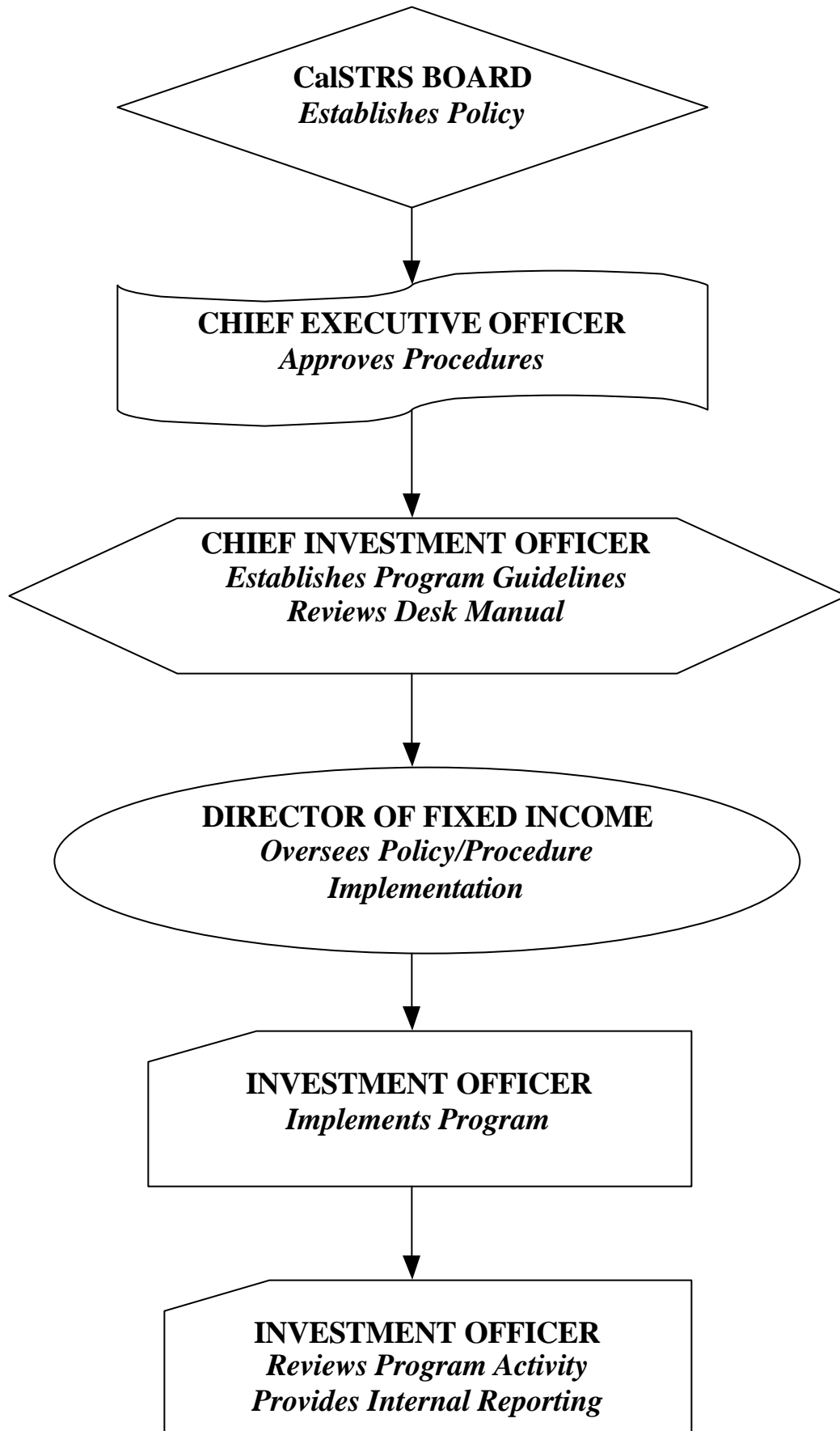
The long-term fixed income portfolios invest in a wide range of dollar denominated securities, including, but not limited to:

- U.S. Treasury Bonds/Notes
- U.S. Agency Bonds/Notes
- U.S. Government-Sponsored Corporations
- U.S. Corporate Bonds, Notes, and Medium Term Notes (publicly traded & privately placed)
- Mortgage Backed Securities (publicly traded & privately placed)
- Whole Loans
- Asset-Backed Securities
- U.S. Dollar Bonds issued in the U.S. by foreign borrowers (Yankees)
- U.S. Dollar Bonds issued outside the U.S. (Eurobonds)

These fixed income securities are managed internally by Investment Officers - Fixed Income, under the direction of the Director of Fixed Income within the asset allocation and strategic objectives established by the California State Teachers' Retirement Board (Board).

This policy document outlines the approved policies of CalSTRS' internally managed long-term fixed income portfolios and has been designed to set the boundaries that will ensure prudence and care in the management of the fixed income portfolios while allowing sufficient flexibility in the management process to capture investment opportunities. A flow chart is included to provide the context for the policies within the general process of the management of the internally managed long-term fixed income portfolios. Words and terms that may be unfamiliar to the reader are referenced in the Glossary.

LONG-TERM FIXED INCOME PORTFOLIO FLOWCHART



**California State Teachers' Retirement System
Long-Term Fixed Income Portfolio
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PORTFOLIO POLICIES

~~April 1999~~ *October 2000*

The following represent the approved policies to be utilized in the management of the internally managed long-term fixed income segment of the total investment portfolio. These policies are designed to set boundaries that will ensure prudence and care in the management of the fixed income portfolios, while allowing sufficient flexibility in the management process to capture investment opportunities. Policies approved by the CalSTRS Board cannot be altered without explicit direction from the CalSTRS Board.

1. **Laws and Statutes** – The System's internally managed long-term fixed income assets are to be invested in a prudent manner for the sole benefit of its participants and beneficiaries in accordance with the California State Teachers' Retirement Law and other applicable statutes. No investment instrument or activity prohibited by the Investment Resolution adopted by the Board in 1984, as amended from time to time, shall be authorized for the internally managed long-term fixed income portfolios.
2. **Portfolio Objectives** – The internally managed long-term fixed income assets shall be invested using an enhanced indexing investment strategy in which the strategic objective is to consistently exceed the total return of the performance benchmark with a similar risk profile. The performance benchmark for the internally managed long-term fixed income assets shall be the Salomon Brothers Large Pension Fund Index (LPF Index).
3. **Diversification** – Diversification within investment portfolios is critical in order to control risk and maximize returns. Minimum and maximum ranges with respect to investment sectors, credit exposure, and duration shall be established for the internally managed long-term fixed income portfolios within the context of the characteristics of the performance benchmark. Such ranges shall be documented within the Procedures Manual and are subject to change as conditions warrant, as determined by the Director of Fixed Income.
4. **Trade Execution** – Competitive bids/offers are encouraged for all portfolio transactions. However, there are circumstances which preclude the competitive process during trading. Such exceptions are to be documented on the trade ticket, and the statistics associated with trading activity included in the monthly fixed income report. The Investment Officers shall use their best efforts and discretion at all times to obtain the most favorable trade execution possible for the System.
5. **Authorized Signers** – Authorization letters, which indicate who may transact business for the CalSTRS internally managed long-term fixed income portfolios, shall be sent with a copy of the most recent Investment Resolution, initially at the time an account is opened

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Long-Term Fixed Income Portfolio
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and then periodically to all fixed income broker/dealers with whom CalSTRS conducts business. Whenever a change in authorized signers takes place, the broker/dealers shall be notified in writing, within 24 hours, in the event of termination, and as soon as possible, in the event of a newly authorized signer(s).

6. **Authorization Limits** - The following daily limits apply with respect to the approval of trade activity within the internally managed long-term fixed income portfolios:
- | | |
|--|-----------------------------|
| • Investment Officer I | \$25 million |
| • Investment Officer II | \$100 million |
| • Investment Officer III | \$250 million |
| • <i>Principal Investment Officer</i> | <i>\$350 million</i> |
| • Director of Fixed Income | \$500 million |
| • Chief Investment Officer | \$1 billion |
7. **Trade Processing** - Prior to being processed to Operations, all trade tickets shall be authorized within the limits noted above and countersigned by two Investment Officers within Fixed Income.
8. **Business Plan** – The internally managed long-term fixed income portfolios will be managed in accordance with an annual Business Plan. This plan will include a broad overview of the asset class with the key issues associated with the management of the portfolios, as well as future objectives and a resource allocation study.
9. **Delegation of Authority** – The management of CalSTRS' internally managed long-term fixed income portfolios is delegated to staff within the boundaries established by these policies and the processes described within the Procedures Manual.
10. **Reporting** – Staff will prepare a report summarizing the activities associated with the management of the long-term fixed income portfolios on a monthly basis for the Chief Investment Officer. The report shall provide information regarding portfolio performance, risk characteristics vs. the performance benchmark, and trade execution summaries.
11. **Board Review** – The Board shall administer and review this policy periodically, as it deems appropriate, in keeping with the investment standard.

Adopted by the Teachers' Retirement Board on July 8, 1993

Revised on June 5, 1996

Revised on April 7, 1999

REVISED _____

California State Teachers' Retirement System
Long-Term Fixed Income Portfolio
Policies

GLOSSARY

AGENCY SECURITIES - Investments issued by federal corporations and federally sponsored corporations that are able to issue debt at a lower cost to such constituencies as farmers, homeowners, and students.

ASSET-BACKED SECURITIES - Investments that are collateralized by assets such as automobile loans, agricultural equipment loans, and credit card loans. The loans feature credit enhancements that lead to high credit ratings and limited investor exposure to the credit of the seller.

BANKERS' ACCEPTANCES - Time drafts drawn on and accepted by a bank within one to six months. They are used to provide manufacturers and exporters with capital to operate between the time of manufacturing (or exporting) and payment by purchasers.

BASIS POINT - One hundredth of one percent; .0001 in decimal form.

CASH FORECAST - The projection provided by CalSTRS' Operations division of the sources and uses of cash for the System in the immediate future.

CERTIFICATE OF DEPOSIT (CD) - A negotiable security issued by commercial banks against money deposited with them for a specified period of time. CDs pay interest at either a fixed or floating rate, periodically or at maturity, and the principal when it reaches final stated maturity.

COLLATERAL - Securities and other property pledged by a borrower to secure payment of a loan.

COMMERCIAL PAPER -Unsecured, short term (usually a maximum of nine months) bearer obligations with denominations in multiples of \$100,000.00, issued principally by industrial corporations and finance companies; usually issued at a discount from face value.

COMPETITIVE BIDS - The practice of soliciting more than one bid or offer for a security transaction. It is based on an identifiable asset in accordance with identified fixed rules for all participants.

CORPORATE BOND - A financial obligation for which the issuer, a company, promises to pay the bondholders a specified stream of cash flows, including periodic interest and a principal repayment.

CREDIT RATING - A relative ranking of timely interest payment and principal repayment based on past records of debt repayment, current financial status, and future outlook for the company.

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Long-Term Fixed Income Portfolio
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DISCOUNT NOTE (AGENCY) - An obligation of a federal corporation or a federally sponsored corporation issued at a discount to par value, usually less than one year to maturity.

DURATION - The weighted average maturity of the present value of a bond's cash flow stream. A measure of the change in price for a small movement in interest rates.

EURODOLLAR DEPOSITS - Certificates of deposit issued by banks outside of the United States, with interest and principal paid in dollars.

FAILED TRADE - Purchased or sold investment securities that are not delivered on the contracted settlement date.

INDEX - A defined representative collection of securities used to measure the change in value of the securities market on a monthly basis.

INDEXED PORTFOLIO - Contains a core portfolio of United States Treasury issues, mortgage-backed securities, and corporate securities.

INVESTMENT OFFICER - Any one of the in-house investment professionals in the CalSTRS Fixed Income unit.

LIQUIDITY - The ease with which a bond can be purchased or sold at a fair price in a timely manner.

LIQUIDITY PORTFOLIO - For CalSTRS' purposes, this is the Short-Term Fixed Income Portfolio that provides cash flow for funding transactions for the System, such as benefit payments, investment manager activity, and asset allocation. Examples of short-term investments include U.S. Treasury, Agency, and money market securities (commercial paper, certificates of deposit, Eurodollar deposits, repurchase agreements).

MEDIUM TERM NOTE - Medium Term Notes (MTNs) are corporate or agency debentures. They differ from traditional underwritten corporate bonds only in the process by which they are issued. MTNs typically are offered on a periodic or continuous basis through one or more managers acting as agents.

MORTGAGED-BACKED SECURITY (MBS) - A security that is issued by a federal agency, such as the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association, or the Government National Mortgage Association that is backed by mortgages. Payments to investors are received out of the interest and principal of the underlying mortgages.

MOTIVATION - The force, intent, or impulse that causes the Investment Officer to approach a transaction or series of transactions in a particular way.

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PAR VALUE - The underlying stated value of a bond. The par value serves as the basis for calculating coupon payments and settlement details.

PORTFOLIO - A collection of stocks, bonds or money market securities owned by an investor and segmented by a predefined method.

POSITION - The status of securities, futures, and options in an account - long or short.

PRINCIPAL PAYDOWN - The portion of a periodic payment that reduces the amount of the principal.

PRIVATE PLACEMENT - The purchase of a security directly from the issuing corporation.

QUALITY RANGES - Guidelines for the percentage of market value of a particular credit rating within a portfolio.

RATE OF RETURN - The total income received over a period of time, including interest income, accretion of discount, amortization of premium and change of market value; usually expressed as a percentage or in decimal format.

REALIZED LOSS - The excess of a bond's book value on the date of sale over the sale's proceeds.

REPURCHASE AGREEMENT (REPO) - An arrangement or contract with a dealer to purchase a government, agency or other security at a fixed price, with provisions for its resale at the same price at a rate of interest determined competitively.

SETTLEMENT DATE - For each security transaction, a price is established based on the specifics of the security and the payment date. The payment date, or when the security is exchanged for value, is called the settlement date.

SHELF REGISTRATION - The maximum amount of a MTN issue.

SINKING FUND - The periodic retirement of a portion of a principal amount of a bond issue. A pre-specified schedule determines the timing and the amount of the sinking fund payments.

SPLIT-RATED - The credit ratings of corporate and other securities are made by independent services such as Moody's or Standard & Poors. When a security receives ratings that are different among the rating services, the term split-rated is used to signify this difference in relative credit ratings.

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TRACKING ERROR - The deviation of the portfolio's rate of return from that of the target index or management criteria.

UNITED STATES TREASURY SECURITIES - Debt issues of the U.S. Government, such as Treasury bills, notes and bonds.

WHOLE LOANS - A secondary mortgage market term which refers to an investment in an original mortgage loan, versus a loan which participates in a secured pass-through security.